

Message Text

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ACTION ARA-10

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TAGS: EIND, EFIN, BR. BENC, BEXP

SUBJ: CSN STEEL EXPANSION

SUMMARY. THE GOB HAS MADE PUBLIC A WORLD BANK TELEX THAT RECOMMENDS AN IMMEDIATE SUSPENSION OF CSN EQUIPMENT ORDERS FOR STAGE III EXPANSION. THE TELEX ALSO CALLS FOR CSN USE OF OUTSIDE CONSULTANTS TO RE-EVALUATE STAGE III EXPANSION PLANS. SIDERBRAS HAS RESPONDED TO THIS TELEX IN AN OFFICIAL NOTE THAT ADMITS SOME ADMINISTRATIVE SHORTCOMINGS BUT CLAIMS THAT A CSN MANAGEMENT SHAKE-UP HAS SOLVED THESE PROBLEMS. END SUMMARY.

1. ON SEPTEMBER 8 SIDERBRAS RELAZED A TELEX SENT BY THE WORLD BANK TO THE BRAZILIAN GOVERNMENT ON JULY 22. SIDERBRAS ALSO MADE PUBLIC AN OFFICIAL NOTE RESPONDING TO THE CRITICISMS OF THE CSN EXPANSION PROGRAM CONTAINED IN THE TELEX AND HIM A LETTER (REFTEL) SENT AUGUST 4 TO THE GOB BY THE WORLD BANK.

2. THE TELEX SUMMARIZED THE RESULTS OF A WORLD BANK INSPECTION TEAM WHICH HAD VISITED BRAZIL EARLIER THIS YEAR. THE REPORT RECOMMENDS THAT:

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-- THE SCOPE AND SCHEDULE OF THE CSN STAGE III EXPANSION BE REVIEWED WITH EXTERNAL (I.E. NON-CSN) TECHNICAL CONSULTANTS BEFORE ANY NEW COMMITMENTS ARE MADE.

-- CHANGES BE MADE IN THE MANAGEMENT OF THE EXPANSION PROGRAM AND OUTSIDE TECHNICAL CONSULTANTS ASSIST IN THIS PROCESS.

-- MORE PRECISE ESTIMATES BE MADE OF STAGE III FINANCES.

-- A REALISTIC FINANCIAL PLAN TO BE DRAWN UP. THIS PLAN SHOULD TAKE INTO CONSIDERATION THE ADDITIONAL STAGE II INDEBTEDNESS ASSUMED BY CSN. AN INCREASE IN CSN'S CAPITAL AND STEEL PRICES SHOULD BE CONSIDERED.

-- THE COORDINATION BETWEEN THE FINANCIAL AND TECHNICAL DIRECTION OF THE EXPANSION PROGRAM BE IMPROVED.

3. THE WORLD BANK TEAM FOUND THAT THE CONCLUSION OF CSN'S STAGE I EXPANSION IS FIVE MONTHS BEHIND THE TARGET DATE SET ONLY ONE YEAR AGO. CONSEQUENTLY, 1976 PRODUCTION WILL BE REDUCED BY AT LEAST 400 THOUSAND TONS. CSN STAGE II EXPANSION COSTS HAVE RISEN \$166 MILLION OVER THE LAST YEAR TO \$736 MILLION. CSN STAGE III EXPANSION COSTS HAVE RISEN FROM \$2.115 BILLION TO \$3.530 BILLION (\$2.600 BILLION IN LOCAL CURRENCY) AND THE ACTUAL IMPLEMENTATION OF STAGE III IS 9 MONTHS BEHIND SCHEDULE. THE TELEX ALSO NOTES THAT CSN IS NOW IN FINANCIAL DIFFICULTY DUE TO THE GREATER STAGE II COSTS AND THE DELAYS IN STAGE II IMPLEMENTATION.

4. THE WORLD BANK TELEX CITES SEVERAL REASONS FOR THESE PROBLEMS: POOR ESTIMATION AND MONITORING OF COSTS BY CSN, DIFFICULTY IN EXPANDING AN OPERATING STEEL MILL, FAILURE BY CSN TO MODIFY PLANS WHEN LARGE COST OVERRUNS BECOME APPARENT.

5. IN RESPONSE, THE SIDERBRAS NOTE STATES THAT THE GOB HAS DECIDED TO MAINTAIN CSN'S CURRENT PROCUREMENT POLICY. THE PARTICIPATION OF BRAZILIAN INDUSTRY WILL CONTINUE AS BEFORE. THE NOTE POINTS OUT THAT MANY OF THE COST INCREASES ARE A RESULT OF FOREIGN SUPPLIER PRICE INCREASES. REGARDING A CHARGE THAT THE THIRD CSN BLAST FURNACE WAS INAUGURATED PREMATURELY, UNCLASSIFIED

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SIDERBRAS CLAIMS THAT THERE WERE VALID TECHNICAL REASONS FOR THE TIMING OF THIS INSTALLATION. THE NOTE ALSO OBSERVES THAT THIS FURNACE IS PRESENTLY FUNCTIONING AS EXPECTED (SIC).

6. ACCORDING TO SIDERBRAS, THE HIGHER BRAZILIAN NATIONAL CONTENT IN THE EQUIPMENT FURNISHED FOR STAGE III EXPANSION SHOULD NOT SIGNIFICANTLY RAISE COSTS. THE NOTE POINTS OUT THAT MOST OF THE ORDERS FOR BRAZILIAN EQUIPMENT RESULT FROM

SUBCONTRACTS OF BID COMPETITIONS OPEN TO FOREIGN SUPPLIERS.

7. SIDERBRAS DOES ADMIT THAT CSN HAS BEEN HAVING ADMINISTRATIVE DIFFICULTIES BUT POINTS OUT THAT THREE OF THE CSN DIRECTORS HAVE BEEN REPLACED. THESE CHANGES DID NOT RESULT FROM THE WORLD BANK REPORT BUT FOLLOWED AND INDEPENDENT INVIESTIGATION BY SIDERBRAS. SIDERBRAS ADDS THAT CSN DIFFICULTIES ARE TRANSITORY AND PECULIAR TO THAT ORGANIZATION, NOT COMMON TO THE BRAZILIAN STEEL INDUSTRY.

8. COMMENT: IN THE LATTER REGARD, THOUGH CSN IS THE FOCUS OF THE PRESENT CONTROVERSY, PRESS REPORTS HAVE ALSO INDICATED THAT IBRD HAS CRITICIZED COSIPA, THE SECOND OF THE THREE MAJOR SIDERBRAS STEEL PLANTS.

9. EMBASSY CONCURS IN FOREGOING.
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